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## COLLECTING CHECKS UNDER THE CURRENCY LAW

The Federal Reserve act recently passed by Congress contains provisions affecting the clearing and collection of checks and drafts payable upon presentation which are of vast importance to the business men and bankers of the United States. However, much misunderstanding as to the meaning of the law has been caused by the fact that the provisions of the Glass bill and the provisions of the Owen bill were somewhat conflicting and that the supporters of these two bills finally agreed to a compromise. A compromise unless very carefully arrived at could not but work harm to such a complicated and technical part of the law, and consequently it is necessary to analyze carefully the exact wording of the Glass bill and of the Owen bill in order to arrive at an understanding of the construction that will probably be placed upon this part of the currency law.

There are two sections in the Glass bill, the Owen bill, and the currency law containing provisions for the clearing and collection of checks and drafts. In the Glass bill and the Owen bill, these sections are known as section 14 and section 17, while in the currency law they have been changed to section 13 and section 16. The provisions contained in section 13 are entirely permissive, allowing reserve banks to handle certain checks and drafts providing they wish to do so. The provisions contained in section 16 are mandatory, compelling reserve banks to handle certain checks and drafts under certain conditions.

The following outline contains the provisions of the Glass bill, the Owen bill, and the currency law which affect the clearing and collection of checks and drafts. These provisions have been subdivided in order that corresponding parts of the Glass bill, the Owen bill, and the currency law may be separately considered.

## GLASS BILL

## SECTION 14

That any Federal Reserve Bank may receive from any member bank deposits of current funds in lawful money,

a)

or, solely for exchange purposes, may receive from other Federal Reserve Banks deposits of current funds in lawful money, national bank notes, or checks and drafts upon solvent banks, payable upon presentation.

b)

## SECTION 17

It shall be the duty of every Federal Reserve Bank to receive on deposit, at par and without charge for exchange or collection, checks and drafts drawn upon any of its depositors or by any of its depositors upon any other depositor

c)

and checks and drafts drawn by any depositor in any other Federal Reserve Bank upon funds to the credit of said depositor in said Reserve Bank last mentioned,

d)

nothing herein contained to be construed as prohibiting member banks from making reasonable charges to cover actual expenses incurred in collecting and remitting funds for their patrons.

e)

f)

## OWEN BILL

## SECTION 14

Any Federal Reserve Bank may receive from any of its member banks, and from the United States, deposits of current funds in lawful money, national bank notes, Federal Reserve notes, or checks and drafts upon solvent banks of the Federal Reserve System, payable upon presentation;

or, solely for exchange purposes, may receive from other Federal Reserve Banks deposits of current funds in lawful money, national bank notes, or checks and drafts upon solvent member or other Federal Reserve Banks, payable upon presentation.

## SECTION 17

Every Federal Reserve Bank shall receive on deposit from member banks or from Federal Reserve Banks checks and drafts drawn upon any of its depositors,

and when remitted by a Federal Reserve Bank, checks and drafts drawn by any depositor in any other Federal Reserve Bank or member bank upon funds to the credit of said depositor in said Reserve Bank or member bank.

Nothing herein contained shall be construed as prohibiting a member bank from making reasonable charges for checks and drafts so debited to its account, or for collecting and remitting funds, or for exchange sold to its patrons.

The Federal Reserve Board may, by rule, fix the charges to be collected by the member banks from its patrons whose checks are cleared through the Federal Reserve Bank and the charge which may be imposed for the service of clearing or collection rendered by the Federal Reserve Bank.

## CURRENCY LAW

## SECTION 13

Any Federal Reserve Bank may receive from any of its member banks, and from the United States, deposits of current funds in lawful money, national bank notes, Federal Reserve notes, or checks and drafts upon solvent member banks, payable upon presentation;

or, solely for exchange purposes, may receive from other Federal Reserve Banks deposits of current funds in lawful money, national bank notes, or checks and drafts upon solvent member or other Federal Reserve Banks, payable upon presentation.

## SECTION 16

Every Federal Reserve Bank shall receive on deposit at par from member banks or from Federal Reserve Banks checks and drafts drawn upon any of its depositors,

and when remitted by a Federal Reserve Bank, checks and drafts drawn by any depositor in any other Federal Reserve Bank or member bank upon funds to the credit of said depositor in said Reserve Bank or member bank.

Nothing herein contained shall be construed as prohibiting a member bank from charging its actual expense incurred in collecting and remitting funds, or for exchange sold to its patrons.

The Federal Reserve Board shall, by rule, fix the charges to be collected by the member banks from its patrons whose checks are cleared through the Federal Reserve Bank and the charge which may be imposed for the service of clearing or collection rendered by the Federal Reserve Bank.

## GLASS BILL

## SECTION 17

The Federal Reserve Board shall make and promulgate from time to time regulations governing the transfer of funds at par among Federal Reserve Banks and may at its discretion exercise the functions of a Clearing House for such Federal Reserve Banks or may designate a Federal Reserve Bank to exercise such functions,

g)

and may also require each such bank to exercise the functions of a Clearing House for its member banks.

h)

## OWEN BILL

## SECTION 17

The Federal Reserve Board shall make and promulgate from time to time regulations governing the transfer of funds and charges therefor among Federal Reserve Banks and their branches, and may at its discretion exercise the functions of a Clearing House for such Federal Reserve Banks, or may designate a Federal Reserve Bank to exercise such functions,

and may also require each such bank to exercise the functions of a Clearing House for its member banks.

## CURRENCY LAW

## SECTION 16

The Federal Reserve Board shall make and promulgate from time to time regulations governing the transfer of funds and charges therefor among Federal Reserve Banks and their branches, and may at its discretion exercise the functions of a Clearing House for such Federal Reserve Banks, or may designate a Federal Reserve Bank to exercise such functions,

and may also require each such bank to exercise the functions of a Clearing House for its member banks.

## SECTION 13

## a

The Glass bill provided that any national bank might receive on deposit from any of its own member banks checks and drafts drawn on any solvent bank whether a member of the reserve system or not.

The Owen bill provided that the checks and drafts should be limited to those drawn on solvent banks that were members of the reserve system.

The currency law provides that the checks and drafts shall be limited to those drawn on solvent member banks. As section 1 of the currency law defines a "member bank" as any bank which has become a member of one of the reserve banks, it is apparent that the meaning of the Owen bill is not changed and hence this part of the currency law authorizes any reserve bank to receive on deposit from its members or from the United States checks and drafts drawn on any solvent bank that is a member of the federal reserve system.

## b

Both the Glass bill and the Owen bill provided that any reserve bank might receive certain checks and drafts on deposit from other reserve banks for exchange purposes. The words "for exchange purposes" were used because a reserve bank is given no power to

open an account with another reserve bank except as provided in section 14 of the currency law, where any reserve bank is authorized to establish accounts with other reserve banks for exchange purposes. Under the Glass bill a reserve bank could so accept from another reserve bank checks and drafts drawn upon any solvent bank whether a member of the reserve system or not; but under the Owen bill such checks and drafts were limited to those drawn on any solvent member bank or other reserve bank. The exact wording of the Owen bill was followed in the currency law and as a "member bank" means any bank that is a member of the reserve system, it is apparent that this part of the currency law authorizes any reserve bank to accept on deposit, for exchange purposes, from any other reserve bank, checks and drafts drawn on any solvent bank that is a member of the reserve system or on any other solvent reserve bank.

## SECTION 16

## C

The Glass bill provided that a reserve bank should receive on deposit at par and without any charge whatever, checks or drafts drawn on any bank that was a member of that particular reserve bank. The words "or by any of its depositors upon any other depositor" were unnecessary, as the words "checks and drafts drawn upon any of its depositors" included all checks and drafts on a depositor in the reserve bank, whether drawn by an ordinary depositor or by one of the other depositors in the reserve bank.

The Owen bill omitted the unnecessary words "or by any of its depositors upon any other depositor," and merely provided that any checks and drafts drawn upon any of its depositors should be received on deposit by a reserve bank; but the Owen bill omitted the words "at par," and later on provided that certain charges should be made for collecting these checks and drafts. This part of the currency law is a compromise between the Glass bill and the Owen bill. The exact wording of the Owen bill was followed except that the words "at par" which were used in the Glass bill were inserted in the currency law. However, the words "at par" are offset in the currency law by a subsequent provision

that certain charges may be made to cover the expense of collecting these checks and drafts. This inconsistency is probably the result of a rather hasty compromise; but doubtless the law will be construed to mean that the words "at par" apply to exchange charges proper and that the collection charges later provided for apply to charges to be made for the service of handling the checks and drafts. Consequently, this part of the law doubtless means that any reserve bank must receive on deposit, from any of its members or from any other reserve bank, checks and drafts drawn on any of its own members; and that no exchange charge shall be made although a service charge may be made under a provision which appears later on.

*d*

In addition to the checks and drafts above noted, the Glass bill provided that a reserve bank should also receive on deposit checks and drafts drawn on any other reserve bank. The Owen bill adopted this provision of the Glass bill but added also checks and drafts drawn on any bank that is a member of the reserve system. However, the Owen bill provided that these various checks and drafts should only be accepted on deposit "when remitted by a Federal Reserve Bank." These words were doubtless added in order to make this mandatory section agree with the permissive section which is lettered *b* in the above outline. Both of these sections were apparently intended by the framers of the Glass bill to refer to the same form of transactions, the provision in section 13 being merely permissive, but the provision in section 14 being mandatory and setting forth provisions concerning exchange charges and cost of handling. Hence, as the wording of the currency law follows the exact wording of the Owen bill, it is apparent that this part of the currency law provides that a reserve bank must receive on deposit, from any other reserve bank, checks and drafts drawn on any other reserve bank or on any bank that is a member of the reserve system, without making any exchange charge, although a service charge is permitted under a provision which appears later on.

As the part of section 16 which is lettered *c* in the above outline compels a reserve bank to receive on deposit from any other

reserve bank checks and drafts drawn on any of its own members, and as a check or draft drawn against the reserve bank itself must of course be received on deposit without any provision of law to that effect, it is apparent that this part of the section adds no provision to the law except that a reserve bank must receive on deposit from any other reserve bank checks and drafts drawn on any other reserve bank or on any bank that is a member of some other reserve bank. This part of the law is of no practical value because a remitting reserve bank would prefer (under the provisions of *c*) to send such checks and drafts direct to the reserve bank on which or upon the members of which the checks and drafts were drawn. Furthermore this clause raises the question how a remitting bank would come into possession of any checks and drafts on other reserve banks to remit, for there is no provision in the law allowing a reserve bank to receive such checks and drafts from its members or from the United States. This inconsistency is due to the fact that the framers of the Owen bill apparently misunderstood the meaning of this part of the Glass bill. As noted above, the Glass bill provided that a reserve bank should receive on deposit checks and drafts drawn on any other reserve bank; and this meant that they should be received on deposit by the reserve bank either from its own members, from the United States, or from any other reserve bank. Apparently the framers of the Owen bill inserted the words "when remitted by a Reserve bank" without realizing that this change cut off the provision for a reserve bank to receive on deposit from its own members, or from the United States, checks and drafts drawn on any other reserve bank. Consequently, the change made by the framers of the Owen bill in the wording that was used in the Glass bill not only rendered this part of the law of no value, but actually placed a considerable burden on business because under the law as enacted a member bank receiving a draft on some other reserve bank cannot send it in to its own reserve bank but must collect it through some other channel. This is particularly unfortunate in view of the fact that a member bank (under the provisions of *a*) may be permitted to send in to its reserve bank a check on a member of some other reserve bank, though it cannot send in a draft on the other reserve bank itself.

e

The Glass bill provided that nothing therein contained should prohibit a member bank from charging reasonable fees to cover actual expense in collecting money that was due to its patrons to whom the money so collected was to be remitted.

The Owen bill adopted this provision of the Glass bill and added that nothing therein contained should prohibit a member bank from making reasonable charges for exchange, such as New York and Chicago drafts, which it might sell, or from making reasonable charges for checks and drafts so debited to its account. The words "so debited to its account" were very confusing, because there was no reference in the bill to any process of debiting any account. However, it developed that the framers of the Owen bill intended that a reserve bank, when it received checks on one of its members, should not send them to the member with a request for a remittance less a small charge as is the present practice, but that it should immediately debit such checks against the funds of the member bank which it held, and this provision allowed the member bank to make a charge against the reserve bank when the reserve bank so debited any checks against the account of the member bank. The currency law omitted this last provision altogether and merely provides that nothing contained therein shall prohibit a member bank from charging its actual expense when it collects and remits money or when it sells exchange to its patrons.

f

The Glass bill contained no further provisions in regard to exchange and collection charges, but the Owen bill provided that the Federal Reserve Board might fix the charges that members of the reserve system could collect from their patrons whose checks passed through a reserve bank, and the charges that a reserve bank could make for the service of clearing or collecting checks. The currency law follows the exact wording of the Owen bill, even including a noticeable grammatical error, except that it provides that the Federal Reserve Board *must* fix the charges while the Owen bill only provided that it might do so.

The wording of this part of the law does not make it clear



whether a member bank is authorized to make charges against the patrons who draw the checks that pass through a reserve bank or against the patrons who deposit the checks. However, the views of Senator Owen and his committee as published on November 22, 1913, by the Senate Committee on Banking and Currency, indicate that it was the intention of the framers of the bill that these charges should be collected from patrons who deposit checks that are to be cleared through a reserve bank.

There has been some misunderstanding also in regard to the provision for the charges that a reserve bank can make for the service of clearing or collecting checks, because the currency law provides that certain checks must be received "at par," and strictly speaking, if an item must be received at par no charge can be made.

However, as heretofore explained, expediency will doubtless make it necessary to construe the law as meaning that a reserve bank must receive certain checks at par as regards exchange charges, but that it shall be allowed to make a handling charge in accordance with the rates fixed by the Federal Reserve Board to cover the service rendered.

### *g*

The Glass bill provided that the Federal Reserve Board should make rules governing the transfer of funds at par from one reserve bank to another, and that the Federal Reserve Board could if it wished act as a clearing-house for the reserve banks and thus eliminate to a large extent the shipment of money between the reserve banks; or that the Federal Reserve Board could designate some one reserve bank to exercise these clearing-house functions for the reserve banks. The Owen bill in this regard followed the Glass bill very closely, but changed the provision for the transfer of funds at par by allowing the Federal Reserve Board to provide what charges should be made for transfers of funds between reserve banks. The currency law adopted the exact wording of the Owen bill.

### *h*

The Glass bill provided that the Federal Reserve Board could require each reserve bank to exercise the functions of a clearing-

house for its members. The exact wording of the Glass bill was followed in the Owen bill and in the currency law.

Without this power a reserve bank would doubtless have been compelled to collect the checks and drafts which it received instead of to clear them. In that case a reserve bank would doubtless have collected its out-of-town checks and drafts in accordance with the methods developed by the Boston Clearing-House, sending out daily to each member all checks or drafts which had been received against each such member. The member would have remitted for such items upon receipt of them; and there is nothing in the currency law to prevent the member from deducting an exchange charge as has been the practice in the past.

However, as the Federal Reserve Board may require a reserve bank to act as a clearing-house, the members will doubtless be required to accede to all the rules and regulations made to govern such clearing-house operations. Consequently, all checks on members received by the reserve bank will doubtless be handled in much the same way as checks are now handled by city clearing-houses, except that where a debit balance in a city clearing-house is usually paid in to the clearing-house by the bank, a debit balance in a reserve bank clearing-house will not be paid in by the bank but will be debited by the reserve bank against the funds which the member bank has on deposit with the reserve bank. This may be done because the funds which the member has on deposit with the reserve bank will represent money due the member and the debit balance will represent money due from the member, and by carrying the clearing idea one step farther the debit balance is merely charged against the funds due to the member and the transaction is closed. A credit balance would of course be credited to the funds due to the member. As there is no provision in the law which will permit member banks to make any charges on checks or drafts which have been debited to their accounts, a reserve bank will be able to collect these checks and drafts without any expense other than the cost of handling them; and as the reserve bank is allowed to make a service charge against the members sending in the checks and drafts to be cleared, it will be able to reimburse itself for the entire cost of clearing. Rules and regulations will of

course be made covering the return to the reserve bank of any dishonored checks or drafts, and covering other details of operation.

From the foregoing analysis of the exchange provisions of the new law, the following synopsis of its practical operation can be suggested.

As soon as the reserve banks are fully organized, the depositor in a member bank will find that his checks will be readily accepted throughout the country, whereas formerly he was usually requested to remit in New York or Chicago exchange. He will also find that his checks are returned to his bank, and charged against his account much more quickly than they formerly were. However, the depositor in a non-member bank will find that his checks are handled as in the past but that they are discriminated against and objected to because they will not be collected so cheaply or quickly as checks on a member bank.

When a check on a member bank is received by a business house from one of its out-of-town customers, the business house will deposit it with its local bank. If this local bank is a member of the reserve system it will accept the check just as at present, but the exchange which it will charge the business house will be in accordance with the rules made by the Federal Reserve Board and will be very much less than the present charge that is made under the clearing-house rules. The local bank will then redeposit the check in its reserve bank, which must receive it on deposit if it is drawn on one of its own members and may receive it on deposit if it is drawn on a member of some other reserve bank. The reserve bank will charge the local bank a small service charge which will be fixed by the Federal Reserve Board, but no exchange charge will be made.

If the local bank in which the business house deposits the check is not a member of the reserve system, it will accept the check just as at present and competition will doubtless generally limit the exchange which it will charge to the rate charged by member banks. The non-member bank will doubtless redeposit the check with some bank that is a member, and this member bank will collect it through its reserve bank. This can be done because

there is nothing in the law that prevents a member bank from accepting checks from non-member banks and clearing them through its reserve bank.

When the check received by the reserve bank is on a member of the same reserve bank it will be handled by the reserve bank in its capacity as a clearing-house for its members. As a result of this process the reserve bank will debit the check against the funds which it holds to the credit of the member bank on which the check is drawn, and will then forward it to the member bank with a debit advice. The member bank will thus have no opportunity to make an exchange charge as is the custom at present.

When the check received by the reserve bank is on a member of some other reserve bank, then it will be forwarded to the reserve bank on a member of which it is drawn, and this reserve bank must receive it without any exchange charge, but is allowed to make a small service charge in accordance with the rules made by the Federal Reserve Board. It will then handle the check in its capacity as a clearing-house for its members.

As each reserve bank will have accounts for exchange purposes with the other reserve banks, arrangements will doubtless be made for the reserve bank receiving the check merely to debit it, less the service charge, against the funds which it holds to the credit of the reserve bank to whom it is sending the check. This process will make a further saving of time and labor in handling the check.

The transfer of balances due between federal reserve banks will be made in accordance with rules established by the Federal Reserve Board, and many transfers may perhaps be avoided through the operation by the Federal Reserve Board of a clearing-house for the reserve banks.

This system of collecting checks will result in a large saving in exchange charges to the business men in the large centers. This saving will come about because of two changes in present conditions: first, the elimination of the great waste brought about by the present operation of many independent collection organizations, and the substitution therefor of one compact well-organized collection mechanism; and second, the abolition of exchange charges by member country banks on checks drawn against them. Thus,

while the business men in the large centers will save money, the country banker in the small places will suffer a considerable loss; but the whole system of collecting checks will be much more prompt, efficient, and economical than in the past.

When a check on a non-member bank is received by a business house from one of its out-of-town customers, the business house will deposit it with its local bank, which will handle it much the same as in the past because checks on non-member banks cannot be cleared through the reserve system. The exchange charge which the local bank will make on the check may in time be somewhat less than at present because there may develop in the large centers a tendency to consolidate these checks in out-of-town clearing-houses similar to those in Boston, Kansas City, and elsewhere. However, competition for business may defeat this tendency and as a result little change from present conditions may be experienced as regards checks on non-member banks.

A reserve bank may under the currency law receive from the United States checks on any bank that is a member of the reserve system; but through an apparent error in the law, a reserve bank has no power to receive from the United States drafts drawn on any other reserve bank. Neither has it the power to receive such drafts from any of its members; and consequently, unless the Federal Reserve Board can rectify this apparent error through the adoption of rules and regulations that will be generally acquiesced in, it will be necessary for the government to deposit a draft on a reserve bank only in the bank upon which it is drawn and for a member bank which has received a draft on another reserve bank to forward the draft to some one of its correspondents who happens to be a member of the reserve bank upon which the draft is drawn. This correspondent can of course send it in to its reserve bank because a reserve bank must receive from one of its members a draft that is drawn upon the reserve bank itself. The difficulty may perhaps be obviated if the Federal Reserve Board should rule that the power which is given a reserve bank to open accounts for exchange purposes in other reserve banks is sufficiently broad so that every reserve bank can become a "depositor" in every other reserve bank. Drafts drawn

on other reserve banks might then be considered as drafts drawn against depositors, and as each reserve bank may receive on deposit from its members and from the United States checks and drafts drawn on any of its depositors, the apparent error in the law would be offset.

The currency law touches upon the business of collecting what are usually termed "customers' drafts," and also upon the business of selling New York, Chicago, and other exchange, it being provided that nothing contained in the currency law shall prohibit a member bank from charging its actual expenses for rendering these services.

Many bankers have believed that the free circulation of individual checks should be discouraged in the United States and that drafts on the reserve banks should take the place of individual checks in the remittance of funds over any considerable distances. However, the Reserve act having established the reverse principle as the law of the land, the hearty support of all bankers will doubtless be given to every effort that is made to develop the far-reaching and beneficial changes from present conditions that will come about as a result of the so-called exchange provisions of the currency law.

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